

Estate Tax

An unreasonably high estate tax is forcing the sale or closure of many family-owned businesses

Since 2002, the estate tax rate has gradually decreased while the exemption level has increased—giving small and family-owned businesses some temporary relief. Unfortunately, the legislation that made this temporary phase-out possible included a sunset provision that would limit all of the tax relief to 10 years, with only one year, 2010, free of estate taxes on small businesses. Absent Congressional action, the estate tax was scheduled to incorporate a meager \$1 million exemption and a top tax rate of 55 percent for 2011. Fortunately, Congress did step in at the last minute, but only with a temporary fix.

Federal estate and gift taxes harm family-owned businesses on an ongoing basis because the owner of the business must take various—and often very costly—estate planning measures such as purchasing insurance and/or the creation of trust funds to ensure the future viability of the business. If families do not take these steps, they may have to liquidate the business to pay the estate taxes. The ongoing uncertainty of the estate tax has resulted in more confusion, complexity and estate planning costs for small businesses.

In 2009, the estate tax exemption amount was \$3.5 million (\$7 million for couples), and the top tax rate on inheriting family members was 45 percent on all assets received—including land, buildings, equipment and all other forms of property. Due to Congress' failure to act prior to Jan. 1, 2010, the original language eliminating the estate tax in 2010 went into effect for the near-duration of the year. However, legislation passed in December included a clause requiring the executor of an estate to apply either the 2009 estate tax rates, or the new structure Congress approved which sets an exemption of \$5 million and a top rate of 35 percent. This results essentially in a retroactive tax on the estates of small business owners who passed away in 2010.

In a last-minute act on Dec. 17, 2010, Congress approved and President Barack Obama signed into law, the *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (H.R. 4853)*, settling some major questions about the federal estate, gift, and generation-skipping transfer tax law until Dec. 31, 2012. The law makes significant—but temporary—changes to the federal estate tax structure by providing lower rates and higher exemptions than those that existed previously.

The Tax Relief bill sets the exemption at \$5 million per person and establishes a maximum rate of 35 percent for three years—2010, 2011 and 2012. For estates of individuals who died in 2010, the executor may elect to apply either the 2009 law or the rules under the new legislation. The estate tax provisions are estimated to cost \$68.1 billion over ten years.

The new rules are set to expire on Jan. 1, 2013—with jarring results. Once again, the estate tax will revert back to its 2001 levels—a \$1 million exemption for estate taxes and a top marginal tax rate of 55 percent.

The future of the estate tax regime after 2012 is a cause for major concern for family businesses, many of which are struggling to guarantee that their business survives into the next generation. NSBA urges congressional action on meaningful reform with at least a fully indexed \$3.5 million exemption for individuals, the lowest possible rate, and a step-up in basis, allowing heirs to use the higher basis to figure their gain when the property is ultimately sold.